

INSURANCE AUSTRALIA GROUP

# ANNUAL GENERAL MEETING 2008

Michael Wilkins

Managing Director & Chief Executive Officer

11 November 2008



- Thank you James.
- Good morning ladies and gentlemen, and thank you for attending our AGM today.
- I would like to start by saying I feel very honoured to be given the opportunity to lead a company with such a strong heritage, iconic brands and long track record in helping customers in times of need.
- During my presentation, I plan to discuss:
  - IAG's performance for the 2008 financial year and provide some detail behind the factors which have impacted our result;
  - The revised strategy and operating model we've put in place to improve our performance; and
  - Our outlook for the current financial year.

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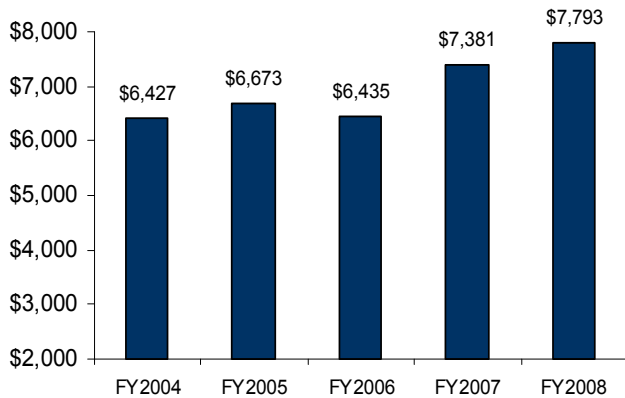
## PERFORMANCE IN 2008



- As mentioned by the Chairman, our financial performance for the 2008 year was disappointing.
- Both external and internal factors contributed to this result:
  - We were affected by the continuing soft cycle in commercial insurance in Australia, and to a lesser extent, New Zealand, and the UK private motor market continued to be challenging;
  - Our businesses in Australia, NZ and the UK all experienced increased costs from claims related to storms and other natural perils;
  - We also started to see early signs of economic and demand-driven inflationary pressures in some of our claims costs;
  - In hindsight, our expense structure in Australia was also too high and, frankly, we were slow to put rate rises through in some of our businesses; and
  - These factors were exacerbated by the impact of weak investment markets.
- We have acknowledged that we need to do better, and let me assure you – we can. We have already taken a number of actions to improve our performance, which I will discuss in a few minutes.
- But first, I will provide some further detail on our financial performance in the 2008 financial year.

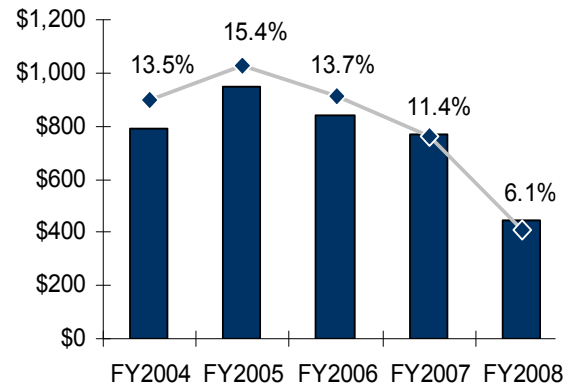
## FINANCIAL PERFORMANCE

### REVENUE



■ Gross written premium (\$m)

### INSURANCE PROFIT



■ Insurance profit (\$m) —◆— Insurance margin (%)

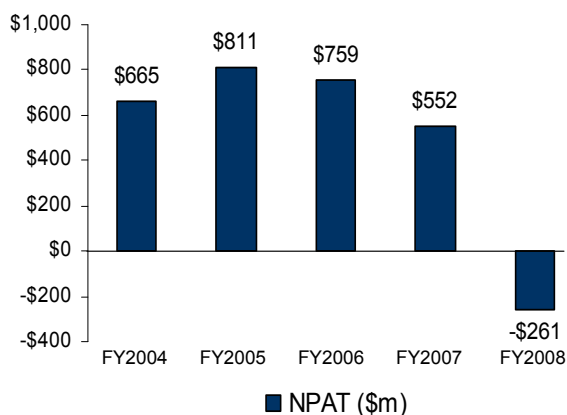
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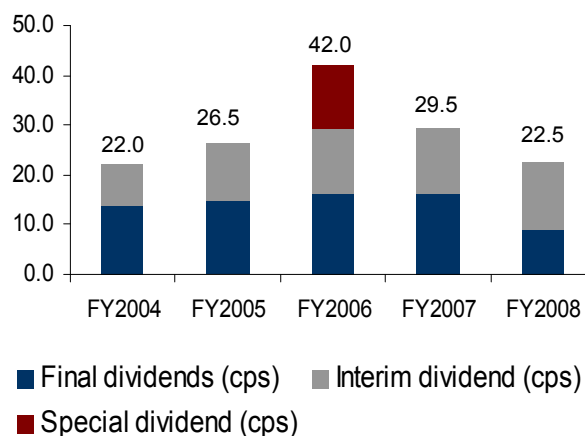
- We grew our top line revenue, or gross written premium, by 5.6% during the year to \$7.8 billion.
- However, our insurance profit was down by \$319m to \$448m. This represented an insurance margin of 6.1%, compared to 11.4% in the previous year.
- This result was adversely impacted by:
  - Increased claims costs from natural perils – while paying claims for damage from storms and other natural perils is a normal part of doing business for an insurer, IAG's businesses incurred \$502m in natural perils claims costs, which is 22% more than the previous year, and 57% or \$182m above our allowances.
  - We also incurred a \$122m adverse impact from widening credit spreads as the credit markets deteriorated, which reduced our insurance margin by 1.7%. It's important to point out that I am very comfortable with our asset quality and we do expect to recover this amount as these securities mature; and
  - Our reserve releases were 16% lower than the previous year.
- At the same time, the income we received from shareholders' funds was significantly lower at \$24m compared to \$301m in the previous year, due to the poor performance of investment markets.

## FINANCIAL PERFORMANCE

### NET PROFIT AFTER TAX



### DIVIDENDS



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- We also incurred one off impairment and restructuring costs in the 2008 financial year associated with our revised strategy, which I'll take you through in a moment.
- When combined with the financial effects of operating in an environment characterised by continuing soft cycles in some of our key markets, another year of high claims from natural perils and volatile investment markets, these factors contributed to the Group reporting a net loss after tax for the 2008 financial year of \$261m.
- In this context, the board declared a reduced final dividend of 9 cents per ordinary share. This takes the full year dividend to 22.5cps, fully franked, which is a reduction of 7cps from the previous year. We took this decision as we felt it was not prudent to continue to pay dividends in excess of our earnings.
- As mentioned, we know we need to do better. We believe the initiatives we are taking, coupled with improvements in our operating environment, will help us improve our financial performance and deliver an insurance margin in the 2009 financial year in excess of 10%.

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## A REFINED STRATEGY TO IMPROVE PERFORMANCE



- In July, I announced a number of changes to our strategy and operating model, which were communicated in a letter from the Chairman to all shareholders at that time.

## STRATEGIC PRIORITIES

### OUR STRATEGIC PRIORITIES

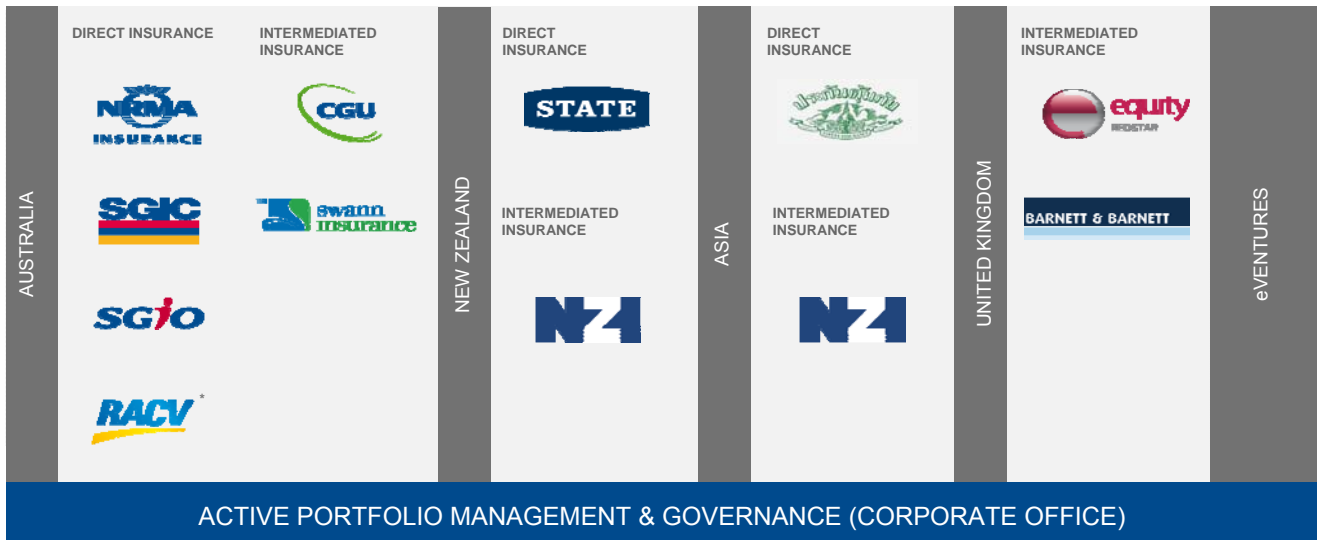
- Improve our performance in Australia and New Zealand
- Pursue selective international growth options – Asia and other narrow specialist opportunities
- A devolved model with the Corporate Office as portfolio manager
- Driving operational performance and execution

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- In that letter we confirmed our strategic decision to remain focussed on general insurance rather than branching out into other classes of insurance or businesses.
- We refined our corporate intent, which is to be a portfolio of high performing, customer-focused diverse operations, providing general insurance in a manner that delivers superior experiences for our customers and creates shareholder value.
- We also refined our targets and will now focus on two key measures, which we aim to achieve through the cycle. These are to achieve:
  - top quartile total shareholder return; and
  - return on equity greater than 1.5 times our weighted average cost of capital. This translates to an ROE of around 15%.
- We needed to make some tough decisions to ensure we got our business fundamentals right and set a course for the future. We now have a clear focus on four strategic priorities:
  - Improving our performance in our home markets of Australia and New Zealand;
  - Pursuing selective international growth options. We still see room for some international growth but it will be more tightly targeted, concentrating on Asia and other narrow, specialist opportunities where we can add value through the transfer of our specialist insurance skills, particularly in the areas of underwriting, pricing, claims and actuarial activities. This means we are scaling back our operations in the UK to become primarily a specialist motor underwriter through our Equity Red Star business, while looking to sell our mass market distribution businesses – Hastings/Advantage and the branch network of Equity Insurance Brokers;
  - Moving to a simpler and more devolved operating model aligned to customer needs; and
  - Driving efficiency in our businesses with a focus on cost reduction initiatives.

## OUR BUSINESS MODEL AND BRANDS



PAGE 7 • RACV is via a distribution relationship and underwriting joint venture with RACV Limited



- Our new operating model further devolves responsibility and accountability as close to the end-consumer as possible.
- We've removed duplication of back-office roles and our corporate office was restructured with a well-defined remit as an active portfolio manager, designed to deliver value to the Group and our shareholders.
- The impact of all of this was a reduction of around 6% of our Australian workforce, however, we attempted to minimise the impact on customer facing roles.
- These initiatives are delivering \$130 million in annual pre-tax run-rate savings in Australia.

## NEW MANAGEMENT STRUCTURE



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\* Commences January 2009.



- Along with simplifying our operating model, we also simplified our management structure. I believe we now have the right mix of industry and relevant experience in our executive team.
- We recently appointed a new member to the team, Andy Cornish who commences as CEO of our Australian Direct Insurance business in January. Andy is a 32 year veteran of the general insurance industry, with a strong track record in successfully growing profitable businesses across insurance classes. Most recently he was with the second largest general insurer in the UK, RBS Insurance, which is part of the Royal Bank of Scotland Group.
- With the addition of Andy, I believe this is a strong management team with the experience to improve the performance of the Group.

## SUSTAINABILITY PERFORMANCE GLOBALLY RECOGNISED



**Ranked one of the world's most sustainable companies. We have been ranked a global sector leader since 2006.**



**Rated one of the Global 100's Most Sustainable Corporations, World Economic Forum.**



**FTSE4Good**

**A member of the FTSE4Good Index since 2005.**

### **CARBON DISCLOSURE PROJECT**

**One of only 25 companies included in the Australia and NZ Goldman Sachs JbWere Climate Disclosure Leadership Index in 2007.**

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- Our commitment to improving our performance against non financial measures remains as important as our financial performance improvements.
- We made progress against many of our sustainability measures during the 2008 financial year. For example, in line with our 2012 carbon neutral goal, we've reduced our CO<sub>2</sub> equivalent emissions, and will continue to support initiatives that improve the energy efficiency of the buildings we occupy which benefits not only the environment, but reduces our own costs.
- We are proud to have been included again in the Global 100 Most Sustainable Corporations in the World and Dow Jones Sustainability Indexes. While recognising that these benchmarks illustrate our leadership, the bar is high.
- We know we must continue to rise to the challenge of exploring new ways to maintain our leadership position by delivering superior outcomes for our customers, employees and, importantly, our shareholders.

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## DELIVERING ON OUR PROMISES



- Coming up with a new strategy and operating model is the easy part. Delivery is the hard part. I'm pleased to report that we are making good progress.

## DELIVERING ON OUR PROMISES

Priority	Status
Move to a simpler operating model by end of September	✓
Deliver \$130m in annual before tax run rate savings in Australia	✓
Appoint CEO of Direct Insurance in Australia	✓
Pursue select opportunities in Asia	On track
Scale back operations in the UK – sales process underway	On track
Exit from Lloyd's syndicate 4455 ('Alba') and underwriting agency	✓

Our ongoing priority: to focus on driving performance and optimising returns in our home markets of Australia and New Zealand

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- Our operational model was up and running by the end of September.
- The majority of our cost saving initiatives in Australia were also implemented by the end of September.
- As mentioned, we appointed a new CEO to manage our largest business, Australian Direct Insurance, with significant experience.
- We are on track in our pursuit of select growth options in Asia:
  - We are working towards finalising our general insurance joint venture in India with the State Bank of India, which we expect to be up and running in 2009; and
  - Our Malaysian joint venture has also signed a memorandum of understanding to acquire the general insurance business of MAA, and a stake in its takaful business.
- In the UK, Equity Red Star continues to perform well, and our plan to exit our mass market distribution businesses – Hastings/Advantage and the branch network of Equity Insurance Brokers – is well underway. Discussions are continuing with interested parties, and we're exploring all avenues of maximising shareholder value, including selling the businesses as a whole or separately. We are pleased with the progress, particularly given prevailing market conditions. We expect to provide an update on this process by the time we report our half year results in February.
- We also said we'd exit our Lloyd's managing agency and specialist Asian syndicate, Alba, as it was no longer required to support the Group's Asian businesses. As a result, that syndicate stopped writing new business in September and is now in run-off. Diagonal will also be closed as the Syndicate is transitioned to another managing agency.
- Our prime focus is on our home markets of Australia and New Zealand:
  - Our cost initiatives have already been mentioned;
  - In NZ, the implementation of cost savings initiatives during the year are expected to deliver around \$16m in annual savings in FY09 and the business is looking to restore profitability by growing GWP on the back of hardening rates and the 're-launch' of the State direct brand;
  - In our Australian intermediated insurance business, CGU, we will continue to maintain pricing discipline and contain expenses. We've seen promising early signs around the direction of the commercial cycle. To capitalise on this and accelerate the performance of the business, the focus is on customer retention and improving the overall efficiency and effectiveness, in line with our corporate strategy; and
  - The Australian Direct Insurance business has progressed initiatives to support growth at least in line with the market; focus on its core capabilities, including refining underwriting and pricing to ensure premiums reflect changed risks and cost conditions; and delivering new product initiatives and enhancements to meet changing customer needs and market dynamics.



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## FY09 – A YEAR OF REBUILDING



- Now to the current year.

## OUTLOOK REAFFIRMED

**For the year to 30 June 2009, we remain on track to deliver\*:**

<b>Gross written premium growth</b>	<b>0%–2%</b>
<b>Insurance margin</b> (now including corporate expenses)	<b>10%+</b>

\* *Subject to no material movement in foreign exchange rates, no catastrophes or large losses beyond our allowances and no material changes in credit spreads relative to 30 June 2008.*

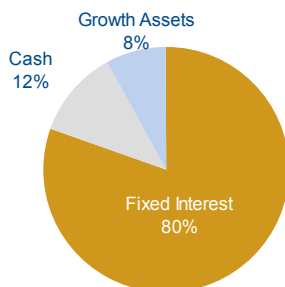
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- The unprecedented turmoil in global financial markets has changed the economic conditions in which we are operating, since we first provided our guidance for the 2009 financial year.
- Despite this change in the environment, we remain on track to deliver our guidance of a 10%+ insurance margin (including corporate costs), and 0%–2% growth in reported gross written premium.
- Our guidance, of course, assumes weather events remain within our normal provisioning and there is no material changes in credit spreads and foreign exchange movements.
- Our largest businesses – Australian Direct and Intermediated Insurance – continue to perform well.
- In New Zealand, our business has had a challenging start to the year having already incurred around \$20 million in claims costs as a result of severe storms across the country in July. However the Group's overall natural perils claims costs remain well within allowances.
- As mentioned, the sale process for some of our UK businesses is underway and we are in discussions with interested parties. I aim to give an update on this process to the market by the time we report our half year results in February.

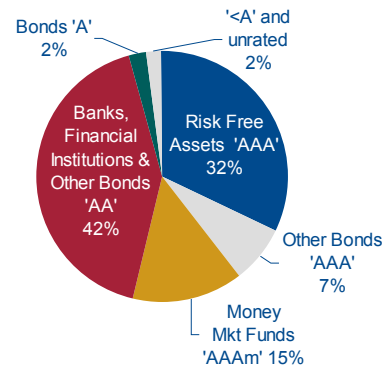
## INVESTMENT MIX STABLE AND HIGH CREDIT QUALITY MAINTAINED

Sept. '08 Investment Asset Exposure - \$11.1bn



Note: Excludes Investment in Associates \$0.1bn

Sept. '08 Fixed Interest & Cash - \$10.2bn



- **Total investment portfolio value is currently \$11.1bn**
- **Only 8% invested in growth assets and 92% in cash and fixed interest**
- **96% of cash and fixed interest invested in assets rated 'AA' or better**
- **Net profit before tax sensitivity to a 10 bpts change in credit spreads unchanged at \$11m**

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- Understandably, given the current turmoil in financial markets, our customers and shareholders want to know that we are positioned well to be able to continue to pay claims and create value for our shareholders, despite the challenging economic conditions. I can assure you we have the fundamentals in place.
- Importantly, IAG maintains a conservative investment strategy to manage its investment portfolio, which currently has a total value of around \$11.1 billion.
- Our investment mix has remained stable since we reported our FY08 result and we have maintained a high credit quality across the portfolio.
- Only 8% of our current portfolio (technical reserves and shareholders' funds) is invested in growth assets, with the remaining 92% invested in cash and fixed interest. 96% of our cash and fixed interest investments is held with high credit quality counterparties rated AA or better.
- In 2H08 we took advantage of credit spreads by increasing our exposure to Australian major trading bank debt which increased the banks and financial institutions component thereby locking in higher running yields. As at 30 September 2008, this component was 42%. These changes will improve our technical reserves returns going forward.
- All credit assets are performing and meeting interest/principal repayment obligations.
- Currently, net profit before tax sensitivity to a 10 bpts change in credit spreads is \$11m.

## IAG REMAINS WELL CAPITALISED

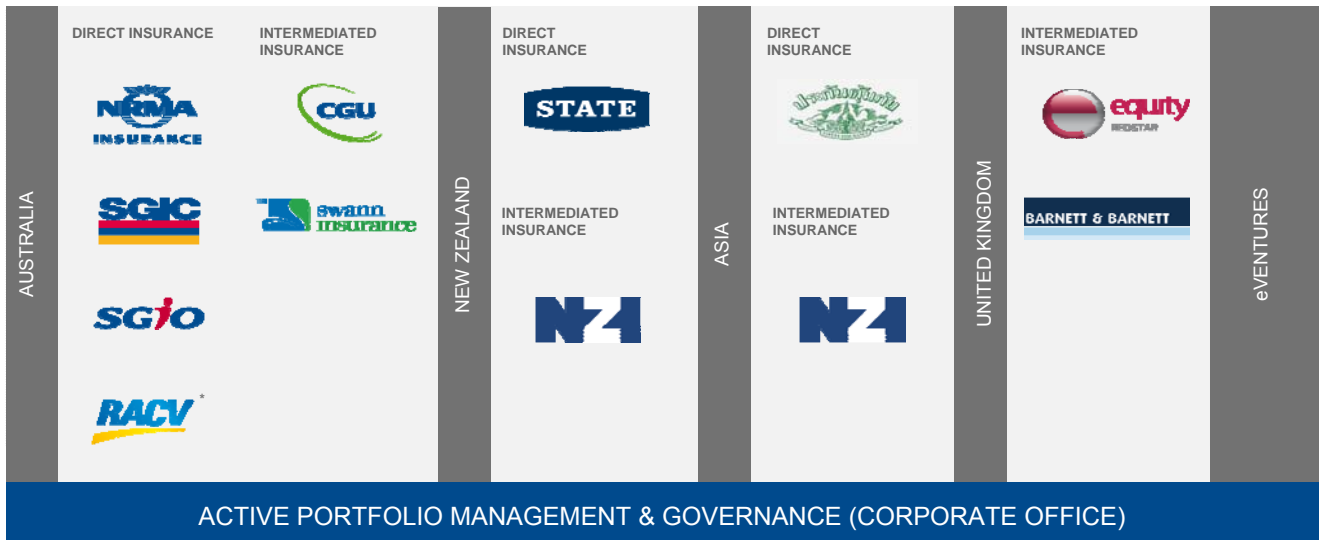
- **Balance sheet and regulatory capital position remain strong**
- **No material debt maturing in either 2008 or 2009 and, in June 2008, held over \$1.25 billion in cash or cash equivalents**
- **Very strong 'AA' category financial strength ratings for key wholly owned insurers**

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- We also retain strong capital and risk management protocols. This is fundamental to the efficient operation of our business and integral in all that we do. Robust capital requirements and risk management protocols have positioned the Australian industry well to ride through this current period of uncertainty and volatility.
- Our balance sheet and regulatory capital position remain strong.
- As mentioned by the Chairman, the Group also continues to have \$550m of pre-funded contingent capital available.
- Debt leverage has fallen as we have reduced the amount of debt we have outstanding. We bought back all \$200m of Reset Preference Shares in June, and in November 2007 we reduced outstanding subordinated debt by around \$220m. These repayments are reflected in our debt leverage dropping from 30% at end of FY07 to 25% at the end of FY08. In relation to funding profile, nearly all of our debt is fixed cost (both rate and margin), and the \$40 million of debt maturing during FY09 was repaid in early August.
- We have continued our strong rating, with S&P rating our key wholly owned insurance entities 'AA minus' with a stable outlook.

## OUR MAJOR BRANDS



PAGE 17 • RACV is via a distribution relationship and underwriting joint venture with RACV Limited



- IAG is a fundamentally sound and well positioned company with great franchises and significant market positions in its home territories.
- We are confident in our revised strategy and the future for the Group.
- Our refined strategy and structure are already having an impact in the short term. But even more importantly, they will continue to drive our future success.
- Thank you.